1812

THE NATIONAL CITY BANK OF NEW YORK

1934

Economic Conditions
Governmental Finance
United States Securities

New York, January, 1934.

Capital Readjustment, The National City Bank of New York

THE Chairman of the Board of Directors of The National City Bank of New York, Mr. James H. Perkins, on behalf of the Board of Directors, addressed a letter on December 5 to the shareholders, for action at the January meeting, outlining a plan for revising the capital structure of the Bank, in line with President Roosevelt's general program of increasing the banking capital of the country.

Banks everywhere are being urged to cooperate in the governmental program, including the stronger institutions in the larger financial centers. In October the New York Clearing House Association adopted a resolution expressing approval of the President's program, and recommending to its members their cooperation in carrying out his suggestion. During the past few months a substantial number of the leading banks, not only in New York City but elsewhere as well, have given active support to this plan or announced their intention of doing so.

The recommendations of the Board of Directors of The National City Bank of New York are in accord with this general program. Specifically, it is proposed to sell $50,000,000 of 5 per cent cumulative preferred stock to the Reconstruction Finance Corporation, subject to the right of the common shareholders to subscribe if they wish to do so. At the same time it is proposed to decrease the common stock from $124,000,000 to $77,500,000 by changing the par value from $20 to $12.50 per share, and with the capital thus released to pursue the conservative course of writing down doubtful assets.

In framing the plan, the directors have been concerned that it shall be genuinely conservative. To this end it includes an unallocated general reserve of $40,000,000, constituting a provision against the uncertainties of the future, over and above any reserves appearing in the published statement. Mr. Perkins in his letter to stockholders expressed the belief that the annual requirements for preferred dividends and the retirement fund should not interfere with reasonable dividends on the common stock even under present conditions. The availability of current earnings for dividends on the common stock will be strongly protected by the existence of this reserve. It can also be used, if there is no need for it, for the retirement of the preferred stock, if that should be deemed advisable. The entire program has been approved by the Comptroller of the Currency and the Federal Reserve Board.

The adoption of this plan will give the Bank added strength through the acquisition of new capital, and will increase its capacity for expanding loans and investments, as soon as business revives. The common shareholder is not asked to supply the money to fortify his own position.

The letter of Mr. Perkins to shareholders follows in full.

To the Shareholders: **December 5, 1933.**

In these times the obligation of a commercial bank to its depositors, customers and shareholders is to pursue a conservative policy, maintain an adequate degree of liquidity, reduce expenses, and increase reserves. In the eight months since I last wrote you we have proceeded on these lines. Expenses, including officers' salaries, have been and are being cut, and methods of operation simplified, with resulting economies and increased efficiency.

Our Directors feel that the Bank should support the President of the United States in his program of strengthening the capital structure of the banks of the country and in his campaign to bring about business and industrial recovery. They also feel that we should accept the offer which the Government has made to purchase preferred stock in national banks. In connection with this offer the President has said: "I understand the question has been raised in some quarters that the Government wants to control the banks through the ownership of preferred stock. Nothing could be further from the truth. The Government only wants to help provide banking capital adequate to meet the credit needs of the country, and through buying, and lending upon preferred stock and capital debentures, it accomplishes this without undue demands upon present shareholders." (In the case of national banks the Reconstruction Finance Corporation is only authorized to purchase preferred stock.)

We are proposing that the Bank co-operate with the President's program; that it increase capital stock by issuing and selling to the Reconstruction Finance Corporation at par and accrued dividends, (subject to being first offered to our own shareholders), $50,000,000 of 5% Cumulative Preferred Stock, and that at the same time it decrease the Common Stock from $124,000,000 to $77,500,000 by changing the par value from $20 to $12.50 a share without, however, changing the number of shares outstanding.

The Comptroller of the Currency and the Federal Reserve Board, which have jurisdiction in the matter, have given their approval, on condition that the capital released by such reduction of par value of shares be applied to writing down assets, and that no distribution on account thereof be made to shareholders. After using the released capital in this way, and after transferring $10,000,000 from Surplus to, and applying and readjusting, reserves, the new set-up will be:

Preferred Stock, 5% cumulative	$50,000,000.
Par value of shs. $20 (2,500,000 shs.)	
Common Stock	77,500,000.
Par value of shs. $12.50 (6,200,000 shs.)	
Surplus	30,000,000.
Undivided Profits about	5,000,000.
Total	$162,500,000.

and, in addition, unallocated reserves, not appearing in the statement, of about $40,000,000.

With the adoption of the plan, the assets of the Bank will be carried at conservative values, and it will be reasonable, in my judgment, to expect substantial recoveries with the return of more normal conditions. The book value of our common stock on the new basis, including the net worth of the City Bank Farmers Trust Company, but excluding the $40,000,000 general reserve and any interest in The City Company of New York, Incorporated, (formerly The National City Company), will be in excess of $21 per share.

On the plan becoming effective I expect to recommend the payment on February 1st next of a dividend of 25 cents a share on the common stock for the last quarter of the present year.

It is planned to continue the City Bank Farmers Trust Company as a separate entity, devoted to trust business. It has present Capital of $10,000,000., Surplus $10,000,000., and Undivided Profits in excess of $1,500,000. Existing laws sanction its continued affiliation with the Bank, provided it becomes a member of the Federal Reserve System. This it plans to do in the near future.

You were advised by me last April that a complete separation of operating personnel had taken place between the Bank and The National City Company. Since then the latter has removed to other offices, changed its name to The City Company of New York, Incorporated, and a separation of directorate has occurred, but, on account of the times, progress towards disposing of the Company or of its business and facilities has been slower than was anticipated. Steps to realize on the material values which exist will be continued during the period allowed by law. In order that the Trustees who hold the stock of the Company, and the Board of Directors of the Company, shall have the requisite power to deal with the situation as it may develop, a Consent to the amendment of the Trust Agreement is enclosed for your signature.

You will also find enclosed a formal notice of the Annual Meeting of the shareholders of the Bank, to be held on Tuesday, January 9, 1934. Attached thereto are proposed amendments to the Articles of Association of the Bank which set forth, among other things, the terms and provisions of the new preferred stock. From these you will note that the preferred stock is retirable in whole or in part at par and accrued dividends, and that an annual retirement fund is provided from earnings. It is not thought that the annual requirements for preferred dividends and the retirement fund should interfere with reasonable dividends on the common stock even under present conditions. As preferred stock is retired, the value of the common will correspondingly increase.

As the Reconstruction Finance Corporation has agreed to purchase the entire $50,000,000 of preferred stock you are not obligated in any way, or solicited, to subscribe. However, the Board has directed that such preferred stock be offered pro rata, at par and accrued dividends (if any), to the shareholders of record at the close of business on December 15, 1933, and that such shareholders shall have the right so to subscribe and pay for such preferred stock up to and including January 9, 1934. Subscription forms will be supplied on request.

Upon completion of the plan you will be asked to send in your present certificates of stock in the Bank to be exchanged, share for share, for new common stock certificates. These will bear an indorsement evidencing beneficial interest in the City Bank Farmers Trust Company, the capital stock of which (other than Directors' shares) will continue to be held in trust as at present, for the sole benefit of the common shareholders of the Bank. Such new certificates will not bear any indorsement with reference to The City Company of New York, Incorporated, although the stock of the latter will continue for the time being to be held in trust as heretofore, and also solely for the benefit of the common shareholders.

The Board of Directors has approved the plan, and recommends to the shareholders that it be made effective.

The plan requires the approval of two-thirds of all the outstanding shares. Unless you expect to attend the meeting you are, therefore, requested to sign the enclosed proxy in order to enable your stock to be voted at the meeting, and also the Consent relating to The City Company of New York, Incorporated, and return both promptly in the enclosed envelope.

Yours very truly,

JAMES H. PERKINS,
Chairman of the Board of Directors.

Terms of Proposed Stock Issue

The provisions surrounding the issuance of preferred stock are in accord with the usual principles on which such issues are based, namely, that the holders will be entitled to preferred treatment as to earnings. Dividends, as already stated, will be cumulative at the rate of 5 per cent. In case, however, of stock sold to the Reconstruction Finance Corporation and retired within three years, the Government has agreed that there will be an adjustment of the rate to 4 per cent.

Preferred stock may be retired out of earnings, recoveries from losses, appreciation of written-down assets, unallocated reserves, or with funds derived from the sale to common shareholders of new preferred or new common stock. Beginning after December 31, 1935, an amortization fund will become effective, which will provide automatically for the retirement of five per cent of the issue each year.

Out of a total of 8,700,000 common and preferred shares, if the present program is adopted, common shares will number 6,200,000, against 2,500,000 preferred shares, of which the holdings by the Government will be 2,500,000 less the number for which common shareholders subscribe. Equal voting rights will ordinarily attach to each share of common and preferred stock, including cumulative voting for the election of directors as provided for in the Banking Act of 1933, which provision is applicable to all national banks

alike. Only in the event of a failure on the part of the Bank to discharge its obligations to the preferred stock with respect to dividends for more than a year, and with respect to the amortization provisions, or in the event of an impairment of capital, or a violation of the Articles of Association, would the preferred stock be entitled to special voting privileges. Under such circumstances the holders of a majority in amount of the preferred stock would have the right to intervene in matters of management.

The Question of Bank Earnings

Comparison, however, of the preferred stock dividend requirements with the current rate of earnings of the Bank indicates a wide margin above such requirements. Two and a half million shares of 5 per cent preferred stock of $20 par means annual dividend requirements of $2,500,000, plus a further sum of not exceeding $2,500,000 for the requirements of the preferred stock retirement fund after December 31, 1935.

Against these requirements, the earnings of the Bank for 1933, after expenses, taxes, normal reserves, depreciation, etc., and with figures for December estimated, will approximate $12,000,000, thus covering preferred stock needs and leaving a large balance available for the common stock. This, moreover, does not take into account any profits of the City Bank Farmers Trust Company. Expenses of the Bank were cut about $1,500,000 last year, and further substantial economies will undoubtedly be effected during the coming year.

Disposition of Investment Affiliate

Mr. Perkins also asked shareholders to sign a "consent" to the amendment of the trust agreement relating to The City Company of New York, Inc., formerly The National City Company. As stated in his letter, divorcement of The National City Bank and The National City Company has been in progress since last Spring, during which time the name of the latter was changed, and new quarters and a separate directorate chosen. Under the Banking Act of 1933 security affiliates of all national banks must be completely divorced on or before June 16, 1934. The stock of The City Company of New York, Inc. is at present held in trust for the benefit of the common shareholders of The National City Bank. The shareholders are asked to give their Trustees the powers which they need to deal with the Company and its assets as the situation may require, for the benefit of the common shareholders of the Bank.

Both this "consent" agreement, and the plan of recapitalization generally, will require the approval of the holders of two-thirds of the outstanding shares.

General Business Conditions

Reports from trade and industry during the closing month of 1933 have been the best since early Summer. Except for the holiday retail sales, December business news is not usually inspiring, since it reflects the disposition of business men to reduce inventories as the year-end approaches, and to curtail buying and productive activity accordingly. In the textile and other industries making goods of everyday consumption this curtailment has been evident during the month, the cotton goods and hosiery industries having evoked the code authority to accomplish a uniform reduction in working hours. In steel, construction and automobiles, however, the reverse has been the case. Steel especially has turned in a notable performance. Responding to an increase in shipping orders against contracts, the weekly rate of operations rose from the November average of 27.3 per cent of capacity to 34.2 just before the holidays. This is the first gain made during December in many years. Moreover, much business now maturing, including railroad and public works orders and automobile requirements after January, is still to reach the mills, which indicates that the gains will be well sustained. The scrap markets, always sensitive, have strengthened.

Awards of building contracts in all classifications have been greater than in November, the daily average increase in the first half of the month having been 40 per cent. Compared with a year ago the increase was 200 per cent. The automobile manufacturers have increased production on new models. November sales were more than double a year ago, dealers' stocks are very low, and this industry will give steadily increasing support to general business in the next three months.

Other measures of general business activity, including freight car loadings and electric power production, have made a better showing than is normally expected in December. Rising totals of car loadings were reported in the first half of the month, an unusual occurrence this late in the year.

All this is evidence that a halting point has been reached in the decline in business which has been under way since July. The improvement has come precisely where it is needed to give balance to the industrial situation, since it is in the heavy industries that most of the unemployment is concentrated. Moreover, the reports of Christmas retail trade have surpassed expectations, and are extremely heartening to some of the industries which have been curtailing since Summer for want of a

better consumer demand. Department store sales have made their best showing since August. The gain in dollar sales during the first half of December, compared with 1932, was 18 per cent, according to a survey by the National Retail Dry Goods Association, and other reports indicate that during the second half of the month the increase may have been larger. Figures for the mail order houses and general merchandise chains are not generally available beyond November, but in that month sales were in some cases 25 per cent larger than last year, and the December reports are favorable.

These gains, to be sure, are accounted for in considerable degree by higher prices. But the figures are impressive by contrast with the three months preceding, when the gain in dollars was nominal and the volume of goods moved was obviously much below the corresponding 1932 levels.

Sentiment for First Quarter Hopeful

Business sentiment has been encouraged by these reports. Despite existing confusion and uncertainty, merchants and manufacturers in nearly all lines see reason to look forward hopefully to the early months of 1934. Since mid-Summer the surplus of goods put on the market during the short-lived boom has been reduced, and as the necessary adjustments of supply and demand are completed in each industry each may be expected to show improvement, such as has already occurred in steel. Along with this natural recovery, the stimulating effects of the Government expenditures in the construction industries, and through the Civil Works Administration and other channels, will be experienced in increasing degree as Spring approaches. These are two influences for better business in the coming quarter.

It is a notable feature of the situation, looking back over the past six months, that neither the controversies set going by the economic policies of the Government, nor the declines in trade and industry since July, have materially weakened the general belief that business is on the road out of the depression. The economic policies are new in the experience of business men, and are in certain respects the objects of criticism by economists and business leaders. The continued inability of industry to obtain capital through new security offerings, which interferes with the planning of new enterprises and with replacement undertakings that would require new financing, is an obvious handicap upon expansion.

But even among those who feel uncertainty in these particulars, the belief that the long-time trend is upward has sustained confidence. The Fall recession was accepted as inevitable. Recognizing the special influences that caused the upswing last Spring and Summer to go too fast and far, and led to an excess of speculative buying, business men viewed the reaction as a natural corrective rather than as a cause for fresh pessimism. Their hopeful attitude has been fortified by the December reports.

Wage and Price Relationships

In examining the progress of business during 1933, the most important point of inquiry is whether relationships within the economic system have been brought into better balance, or whether, on the contrary, the gains in trade and production have been due to a stimulus of artificial character, whose effects will last no longer than the stimulus lasts. A state of equilibrium in economic relationships is essential if prosperity is to be restored, and this is equally true whether the economic system is, at one extreme, an entirely voluntary organization operating under free economic forces or, at the other, wholly under governmental control. There is no disagreement as to the necessity of restoring the equilibrium, but only as to what readjustments are required and the methods of effecting them.

Outstanding among the changes in economic relationships in 1933 are two: a part—unfortunately a small part—of the unemployed have been put back to work, at higher wage scales; and prices have been raised. The advances in wage rates, together with shortened hours, have of course increased manufacturing costs and prices of finished goods, thus raising the cost of living. This rise, which has been 8.8 per cent since the low point, according to the National Industrial Conference Board, has almost exactly offset the increased money wages received by continuously employed industrial workers. Hence these workers have not had their purchasing power increased. However, there has been an increase in the purchasing power of the whole body of industrial labor, by reason of the greater employment. The number of workers employed in November was 30 per cent larger than in March or a year ago, according to the Labor Department, and payrolls in the manufacturing industries were up 50 per cent.

In the case of the higher-paid white collar workers, professional people, and others who have had no increase of money wages or income, their money now buys less than a year ago, and therefore they have lost purchasing power.

The rise in prices at first advanced the purchasing power of the farmer very rapidly. Prices on the farm rose by nearly 60 per cent from the monthly average of February to that of July, while over the same period prices of the things the farmers buy increased only 7 per cent. Since July farm prices have de-

clined. On December 6 they were about 40 per cent over February, while prices of things bought had continued to advance, and were 18 per cent higher. According to official estimates, the farmers' gross income has increased this year about 24 per cent, including about $300,000,000 received from the Government under the agricultural adjustment program. On balance, therefore, farmers have gained substantially, but the ratio of farm prices to prices of goods bought is only 58 per cent of the pre-war average which the adjustment program hopes to attain.

Retail prices rose rapidly during the Summer, and more slowly during the Fall. On December 1 department store prices were 26.8 per cent higher than in May, and 21.2 per cent above a year ago, according to the Fairchild index. The rise in food prices has been somewhat less.

These figures show that the terms upon which the various groups of the population exchange their goods, services and labor, have been altered in favor of some groups and against others. In some cases the changes have plainly been in the direction of a fairer balance, in others to the contrary. On the whole the situation is far from clear. The question still persists whether the rise in retail prices, and the further advances that are to be expected, can be paid by consumers. The answer will have to be found in the state of retail trade, which during the Fall months was unsatisfactory and under the Christmas influence showed the improvement cited, and thus as yet supplies no very conclusive data.

It is to be borne in mind that, in addition to the purchasing power arising out of production, disbursements of Government credit have also become a very important factor in trade. These expenditures may stimulate business, and thus may cover up a lack of equilibrium in economic relationships. However, if the trade gains thus stimulated are to be held after the expenditures are ended, fair terms of exchange must meanwhile be reestablished.

The Agricultural Outlook

In the efforts to restore balance in the economic system through overhead adjustments, the agricultural program evidently is now providing the major complexities. As stated, the farmer has made gains toward an equality of purchasing power, but has lost ground since July through the decline in prices. The chief area of depression is among the hog raisers, cattle feeders, and dairymen. Hogs in Chicago within the past month have sold down nearly to $3 per 100 lbs., which is not much above the low point of the depression. Cattle also are approximately as low as at any previous time, with current quotations at $5 or thereabout for heavy steers. But corn, which was down to 22 cents in Chicago a year ago, is pegged around 45 cents by Government loans to farmers at that level. Of course, 45 cent corn cannot be fed to $3 hogs and $5 cattle with any degree of success, and the feeding industry is demoralized accordingly.

Despite the slaughter of pigs for the purpose of limiting the hog supply, the Fall hog run has been much heavier than a year ago. Cattle feeders also have been unloading fat bullocks to cut off the feed bill, resulting in glutted markets.

The aim of the corn-hog adjustment program of the A.A.A. is to reduce corn acreage by at least 20 per cent and hog farrowings by at least 25 per cent in 1934. The method is to make benefit payments to producers, out of funds raised by processing taxes on both hogs and corn, and the imposition of these taxes has had some unintended effects. The hog tax was 50 cents per 100 lbs., effective November 5, raised to $1 December 1, and scheduled to be advanced to $1.50 on January 1 and $2 on February 1. Doubtless the theory was that the consumer of pork products would pay the tax, but since pork and lard are but two of many foods on the markets, the consumer has had the decision in the matter, and the tax has fallen on the farmer, coming out of the price of hogs.

Thus the results of the hog program have been contrary to the Government's objectives, and the farmers on the whole have been the losers. The hopeful side of the picture is that after the liquidation caused by the unprofitable ratio of corn to hog prices the supply is of course likely to drop off.

Processing Tax Difficulties

The tax on corn processed commercially was set at 5 cents per bushel, and was scheduled to be raised to 20 cents on November 30, but this advance was postponed because corn products such as corn sugar and syrup compete with sugar and sugar products, and it would have been necessary to lay a compensating tax on sugar of half a cent a pound, which the sugar producers doubtless would have had to bear.

This question of compensatory taxes is plaguing the whole processing tax program. A tax on jute fabrics and yarn and certain classes of paper has been declared by the Secretary of Agriculture to compensate for the cotton processing tax, but the cotton goods industry will not consider itself justly treated until the more important competing textiles are likewise taxed. The hog tax has brought out demands for taxes on competing products such as cottonseed oil. In wheat the tax has raised many complications, such as substitution of other flours for wheat flour, and also alleged "bootlegging" through the provision

allowing the grinding of farmers' wheat into flour for their own use free of tax. Whatever merit there is in these charges, wheat consumption appears to be falling off. Flour mill operations have been running below one year ago.

While defending the processing tax, Secretary Wallace is conscious of these difficulties, for in a speech in Chicago on December 12 he informed his audience that some other means of financing the corn-hog program, and reconsideration of "many of the devices employed in the Adjustment Act," might become necessary. He is sounding out Congressional opinion upon a proposal for a $200,000,000 appropriation to carry out a program of reducing the number of cattle and the supply of milk without resort to a processing tax; otherwise a tax of 4 cents per 100 lbs. on fluid milk is likely to be the next step of the A.A.A.

The Government has been an active factor in the markets for farm products, buying for relief purposes. It is agreed that this has been an appreciable support in wheat, but in butter purchases of around 60,000,000 pounds have been ineffective. With production encouraged by the Government support and a surplus of milk, stocks on December 1 were double the five-year average, and the price had a bad break in the middle of the month to the lowest in 35 years. Egg and cheese prices also broke sharply. Meanwhile the dairymen and poultry raisers, like the livestock producers, are at a disadvantage due to the relatively high feed prices.

Wheat Acreage Off 4 Per Cent

The results of the wheat acreage reduction program as revealed by the Government report of Winter wheat seedings are below the objective. The aim was a cut of 15 per cent from the three-year average 1929-1931. The result is a reduction of 7.2 per cent from the base period, and of 4 per cent from a year ago. With the establishment of benefit payments for acreage curtailment, naturally a good deal of wheat land which had not been planted in 1932 was reseeded in 1933, to take advantage of the reduction elsewhere and to become eligible for benefit payments hereafter. The use of the three-year average as the base period enabled numbers of farmers who had reduced their acreage greatly in 1932 to increase it this season, while still qualifying for the bounty. Another interesting aspect of the situation is that the chief curtailment is in the low cost areas in the West, and the chief expansion in the high cost farms of the East. Thus the average cost of producing the crop will be raised, at the expense of the low-cost producer.

The condition of the Winter wheat crop on December 1 is given as 74.3 per cent of normal, one of the lowest figures on record, though better than the all-time low of 69 last year. The figures indicate another small crop, though probably well above 400,000,000 bushels, compared with 350,000,000 in 1933. Efforts to reduce the Spring wheat acreage should be more successful, since there are no high-cost competing areas that can come back into production. Thus the total wheat crop is again likely to be a short one.

Taking the farm situation as a whole, it is clear that difficulties for the administrators of the adjustment program are accumulating. However, influences tending to bring the supply of farm products into line with the demand are working, and the statistical position of the major crops has elements of strength which have justified the price advances of 1933. With his increased cash income the farmer is a greater factor in trade and support to industry than in the past two years.

The Capital Goods Industries

In considering the industrial situation broadly, the chief anxiety is the extent to which the recovery movement will include the construction, machinery and other capital goods industries. It is clear that unless these industries show greater improvement no advance in the consumers' goods group can long be sustained, for when the heavy industries are not giving employment the loss of purchasing power is felt by all other industries and by agriculture likewise.

We have given figures in previous issues of this Letter to show that the chief area of depression over the past four years has been in the capital goods industries. It is also true that these have been the laggards in the upswing; for while many branches of the food, textile and other industries making goods for direct consumption have recovered wholly or nearly to pre-depression levels, only the beginnings of the upward movement have been felt in construction, machinery, railway equipment and similar lines. In the light industries as a whole employment is nearly equal to 1929, but of the capital goods group few are giving work to half as many people as in that year, and some only to one-fourth or one-third as many.

In his excellent new book on "The Economics of Recovery" (Macmillan, 1933) Col. Leonard P. Ayres makes an estimate of the distribution of unemployment in the Summer of 1933, as follows:

	Number Unemployed
Producers of consumption goods	538,000
Producers of durable goods	5,860,000
Producers of services	5,868,000
	12,266,000

From these figures Col. Ayres concludes that unemployment among the producers of durable goods (including durable consumption

goods as well as capital goods) represents the key to the depression; that if they could be put back to work and kept productively employed the unemployment among the providers of services would be absorbed, and the depression would be over. This is a conclusion in which economists generally and the authorities in Washington concur.

The possibility of a natural improvement in the capital goods industries is denied by some upon the plea that the country is already over-equipped with construction and with facilities for production; and this argument, which is advanced in every depression, is receiving more attention than it deserves. It was never more than a half-truth, even in 1929, and obviously it has become less true with each succeeding year, by reason of the depreciation and obsolescence of the construction and equipment in place. The fact is that if no new additions to productive facilities and housing were required, which is never the case, there would still be room for vast expenditures for reconstruction and replacement.

According to the McGraw-Hill organization, in the eleven years 1919-1929 inclusive five-sixths of the expenditure upon capital goods was for new machinery and equipment, and only one-sixth was invested in new plant facilities. It is further estimated that average annual expenditures have been reduced by half during the depression, which is another way of saying that idle machines have been robbed to provide parts for those in use, and obsolescent machinery kept in operation far longer than in normal times. An equivalent situation exists with respect to housing; and during the depression some 3,000,000 automobiles have been retired from use, over and above replacements. Of course the people who have given them up will want them back.

In this manner needs for capital goods and for durable goods generally have grown.

Outlook for Building

The building industry is the most important of the industries which are now most depressed, and the trend of building operations will greatly affect all business activity during 1934. The figures of contract awards have been rising since last March, due largely but not wholly to the increase in public works, which has advanced the percentage of public works and utilities contracts to the total in all classifications from 29.3 per cent at the bottom to 68.4 in the month of November. The total of all contracts awarded during 1933 in 37 Eastern states was about $1,300,000,000, according to the F. W. Dodge figures. This was approximately the same as in 1932, and only 20 per cent of the total in the peak year 1928.

No industry is cited more often than building as an illustration for the argument that the field for capital expenditures is limited, and none with so little justification in the facts. Despite statements to the contrary, the country is not "all built up". Newspapers within the past month have published figures gathered by an N.R.A. survey, not officially released, of construction work that should be done, and the total in all classifications is above $14,000,000,000.

With reference to residential construction alone, the Bureau of Labor Statistics collects figures from 279 cities, and it finds that in the three years, 1930, 1931 and 1932, the increase in the number of families was 757,112, while new residential units were supplied for only 257,300, or one-third. In the important East North Central district the ratio of new dwellings to new families was only one to fourteen. The number of new dwelling units provided for each 10,000 of population was 121.8 in 1925, averaged 92.5 in 1921-1930, and was only 21.4 in 1931 and 5.9 in 1932. The showing was but little better in 1933. The explanation of this great decline is that families are living in dwellings which should be replaced or at least modernized, and that they have doubled up during the depression. A recent survey in Philadelphia showed that while there were approximately 25,000 vacancies, 29,000 families had doubled up with others due to reduction of income.

In one of his articles on "Problems of Recovery", Dr. O. M. W. Sprague made this comment:

> Developed along right lines, I believe it to be possible that improved housing for the mass of people in the United States can do all and more than was done in the Seventies of last century by the expansion of food exports, or a decade ago by the expansion of automobile production. * * *
>
> That a potential demand exists for better housing I think no one will question. While there is perhaps an over-supply for people enjoying incomes of $5,000 and more, present housing conditions of the majority of people with incomes below $2,000 certainly leave much to be desired. I suggest as an objective or as a slogan: One more room for every family in the United States below the income level of $2,000. This is by no means an impracticable objective if building costs can be reduced. In addition, of course, lower costs would induce a large demand for labor and materials employed in making improvements in the homes of those enjoying larger incomes.

This makes the important point that lower costs would expand the market for housing. According to the New York Federal Reserve Bank building costs in October were 69 per cent above 1913 and 10 per cent above the low point in February, 1933. The index of wages was 204 (1913=100); material prices were 148, compared with the low of 123.

No one can venture to predict how much of this possible market will be regained by the construction industry in 1934. Public works expenditures as now contemplated will touch but little on the field of residential building,

though a few slum clearance projects are included. It is taken for granted that public works will supply the chief support for the 1934 building figures, and will cause a substantial increase in the total over 1933. In addition, the present slight upward trend indicates that the volume of residential building will exceed that of the past two years.

The Machinery Industries

The machinery industries have sunk to a low state during the depression, and while showing a moderate improvement in the second half of 1933 have given little support to general business. At the best point of the year machine tool orders were 25 per cent of the 1929 average, and the expectations of machinery manufacturers generally for 1934 are not running high. Yet the huge potential market that exists for machinery is suggested by the estimate of the American Machinist made four years ago that half the machines then installed were more than ten years old, and hence presumably obsolete, and of course the situation is far worse today.

The increase in wages and decrease in hours in the manufacturing industries under the codes, which raises the labor costs of production, is a favorable factor for the machinery maker, stimulating the installation of labor-saving and cost-reducing machines insofar as the codes permit. There was improvement in textile machinery sales during the Fall for this reason.

In machinery industries of all kinds the depression has been a period of intensive progress in design, and out of this progress have come tools and equipment far advanced over 1929. One illustration is the introduction of the Diesel tractor, which has revolutionized the standards of tractor operating efficiency and economy. It is claimed that the heavy Diesel tractors, used in construction, agriculture, logging, etc., will show a fuel saving of $3 to $7 per day at normal relations between gasoline and Diesel fuel prices; and instances are cited of reductions of 75 per cent in the labor and fuel cost of tractor plowing. At this rate it is evident that purchases of new tractors will soon pay for themselves, and this is true of new machines generally.

All this illustrates the function that investments of new capital in industry perform. They reduce costs of production, enable goods to be sold at lower prices, and raise the real wages of consumers. There is no question as to the extent of the potential market for machinery replacement that exists in the old industries, and of course new machinery is being created for new purposes continuously. The handicap to the prospect for the machinery industries in 1934 is not lack of incentive to replace and modernize equipment, but lack of confidence and lack of capital.

Railway Purchases Needed

Expenditures of the railways for materials and supplies normally represent one of the most important demands for the products of numerous industries. In the five-year period ending with 1929 the railroads consumed 25 per cent of the coal and 20 per cent of the fuel oil used in the United States, 39 per cent of the steel castings, more than 20 per cent of the lumber, 8 per cent of the cement, and 20 per cent of the finished iron and steel. Their new capital expenditures from 1922 through 1930 averaged $717,000,000 annually, and their maintenance expenditures $2,046,000,000. In 1932 these figures were reduced to $167,000,000 and $970,000,000 respectively. The railway equipment industries in consequence have been almost paralyzed.

Of all locomotives owned by the Class I railroads, well over half are now more than twenty years old, and only 16.7 per cent less than ten years old. Of freight cars 180,000 more have been retired during the depression than have been installed, and the proportion of bad order cars has increased from 5.4 to 15.4 per cent. Passenger cars have been retired and maintenance drastically cut. As to the fixed properties of the roads, it is estimated that at least $700,000,000 would be required to restore them to the high standard of physical condition that they enjoyed at the close of 1929.

Such figures as these are regarded by many as of academic interest, since in the low state of traffic reductions in expenditure do not cause fully equivalent reductions in efficiency, due to the least efficient equipment remaining idle. However, the situation will change rapidly when traffic improves. Moreover, railroad equipment is being improved steadily by inventive genius, and the rate of obsolescence hastened. Aluminum cars are a commercial reality. The new light weight, streamlined, articulated trains which are being tried out give a striking example of the changes that may come, and require new capital investment. Even in depressions improvements in shops, yards and terminals are endlessly required.

Unquestionably the controlling factor in railway purchases in 1934 will be the ability to finance them, and not any lack of requirements. Unfortunately the roads themselves can finance little beyond urgent maintenance, and while they may receive Government assistance they are naturally reluctant to incur indebtedness of this character in any greater amounts than they find necessary. If they could borrow for long terms and were better

assured of their future their buying policies undoubtedly would be very different.

The street railway industry is in a position analagous to the railroads. It has cut its expenditures on new plant and equipment in half during the depression, and reduced its maintenance almost as drastically. It has developed new cars which start and stop more quickly, run faster and more quietly, and have vastly improved riding qualities. These cars represent, according to Thomas Conway, Jr., chairman of the Electric Railway Presidents' Conference Committee, as great an advance "as does the 1933 model Ford over the old Model T." Buses are needed to replace rail cars, and the trolley bus development is still in its infancy. Mr. Conway says:

> What this industry needs to re-establish its credit is more traffic—not only the business which will return to it when workers are again employed, but the traffic which has deserted us for the private automobile or other more attractive forms of transportation. I am firmly convinced that the new car, if intelligently handled, will make this possible, but only if the introduction of the new cars has been carefully planned, and if an entirely new conception of service is realized.
>
> Unless funds can be secured from the Federal Government, or there is a restoration of normal financial conditions, the financing of new cars will for a time be impracticable for a large proportion of our member companies.

No Limits to Expansion

The foregoing necessarily gives but a few of the high lights in the capital goods industries, with the purpose of showing that they are bearing the brunt of the depression, that their revival is necessary if the depression is to be overcome, and that it is not a lack of needs for capital goods which bars this revival. Beyond doubt it is in these lines that people will eventually be put back to work. Not much expansion in 1934 is to be hoped for in the textiles, which are giving approximately as much employment as ever before in their history, and for several months in 1933 operated at higher levels than in 1929; nor in foods, since food has been continuously provided in one way or another for those unable to purchase it themselves; nor in similar industries making consumption goods. The opportunities are in the heavy industries, where limits to expansion literally do not exist. Capital goods, and durable goods generally including automobiles, houses and all that goes with them, largely constitute the wealth of the world, and no nation ever had enough of them.

An increasing demand for durable goods is characteristic of every progressive society. There are 1700 research laboratories in the country, compared with only 200 ten years ago, and all are turning out new products and new methods of making old ones. At the Exposition of Chemical Industries in New York during the past month 112 products developed since 1930, selected from 700 offered by sixty manufacturers, were on exhibition. The textile industry has developed during the depression run-resistant hosiery, crease-resistant goods, floor coverings fabricated without a loom, elastic yarns and other compounds embodying rubber, and synthetic furs.

The goods demanded by consumers, the goods offered them, and the methods of making them are constantly changing. New products require new machinery to produce them, and new facilities to transport and distribute them, all requiring capital investment. The aviation, air conditioning, synthetic fiber, chemical and electrical industries are still in infancy. The development of new alloys and synthetic products goes on steadily and leads to new developments in other lines. Automatic operation is made possible by automatic devices controlling heat, moisture, etc. The photo-electric cell has added a new mechanism of control. Combustion equipment is constantly improved. Insulation against heat and sound, and deodorizing, open up new fields.

These citations could be extended indefinitely, but they are sufficient to show that progress is constant in all the industries. The new discoveries are made possible only by the risk of capital, and their application only by the accumulation and investment of capital. Out of discovery and development making use of capital has come all the industrial progress that has been known.

Requirements for Capital Goods Recovery

The requirements for recovery in the capital goods industries may be defined as three in number. There must be a market in which the savings of individuals can be accumulated and invested in the industries needing capital, in which securities representing these investments can be bought and sold and new offerings placed, and refunding operations carried out. With respect to new offerings the usefulness of the capital markets in this country has been impaired by certain features of the Securities Act which should have the attention of Congress.

Second, there must be confidence on the part of investors that the dollars they lend will be the same dollars when they are paid back, and this confidence has been lacking due to fears of inflation.

Third, there must be on the part of business men the will to borrow or to expend their own resources, and the essential requirement is that they must have confidence in their ability to use the new funds profitably. The greatest factor generating this confidence is a sound business situation, with economic relationships in such balance that trade prospects are good.

It will be recognized that in all three of these respects the situation is unsatisfactory, but that in none are the handicaps insur-

mountable. Meanwhile the Government policy is to assist the capital goods industries by creating work for them by its own expenditures or expenditures financed by it. The assistance will be helpful, but for obvious reasons can be only partial and temporary. In the last analysis the problem is to revive self-supporting industry, and to restore the investment markets.

The Silver Purchase Plan

The announcement by the President on December 21 of the Government's new silver purchase plan marks a new step in the development of the Administration's monetary policy. The plan contemplates the purchase by the Government of at least 24,421,410 ounces annually from the domestic supply of newly mined silver over the next four years on terms equivalent to 64½ cents an ounce, or slightly more than 20 cents above the open market price at the time the plan was announced. The coinage value of silver continues to be $1.29 an ounce, as established by law, but in buying silver bullion from the producer, the Government has elected to make the "seigniorage," or charge ordinarily exacted to cover the cost of coinage, 50 per cent of the tendered metal. This makes the net price of the silver to the producer one-half of $1.29, or 64½ cents.

Under the operation of the plan, half of the silver received from the producers will be held in the Treasury and cannot be disposed of prior to December 31, 1937, except for coining into United States coins. The balance of the silver accepted under the plan will be coined immediately into silver dollars, and the same or an equivalent amount of dollars returned to the seller. In this way, the operation can be said to cost the Government nothing in the sense of its involving a charge on the budget. What happens is that the supply of money is increased by the amount of the coined dollars.

In announcing the plan, the President stated that the action taken was in accord with the terms of the agreement on silver reached at the London Conference last Summer and signed by the delegates of eight countries chiefly interested in silver, including, as large holders and users of silver, India, Spain and China; and as large producers of silver, the United States, Mexico, Canada, Australia and Peru. According to the terms of this agreement, the Government of India engages for a period of four years beginning January 1, 1934, to limit its sales of silver to an annual average of not more than 35,000,000 ounces; the Spanish Government promises to sell not more than an average of 5,000,000 ounces annually; and the Chinese Government agrees not to sell silver resulting from demonitized coins.

In return for these concessions, the governments of the five silver producing countries agree, as their part of the bargain, not only not to sell any silver during the life of the agreement, but also to purchase silver from their domestic production to a combined total of 35,000,000 ounces annually. Of this total it has been agreed that the share to be purchased by the United States Government should be at least 24,421,410 ounces.

In addition to the above provisions, all the contracting governments agree to refrain from further debasing their silver coinage below a fineness of 800/1000, and to substitute silver coins for low denominations of paper currency as far as domestic conditions will permit.

The agreement is subject to ratification by the various governments concerned, with action by any government to carry out the provisions of the treaty deemed sufficient to effect ratification for that government. Prior to the proclamation just made by the President of the United States, only the Government of India had ratified the compact, leaving the governments of the remaining six countries still to act.

Probable Scopes of Purchases

Though the new program is stated to fulfill the terms of the London Agreement, the wording of the President's proclamation appears to lay the way open for purchases of silver in excess of those required by the London pact. Whereas the latter agreement calls for purchases by five governments to the amount ot 35,000,000 ounces annually, of which not less that 24,421,410 ounces annually is to be bought by the United States, the President's proclamation merely states that each United States mint shall receive for coinage "any silver which such mint . . . is satisfied has been mined, subsequently to the date of this proclamation, from natural deposits in the United States or any place subject to the jurisdiction thereof." It would thus appear that the Government, if it chooses to do so, may purchase the entire domestic output. In 1932 this amounted to approximately 24,000,000 ounces, or slightly below the minimum quota set for this country in the London agreement. Normally, however, production in this country runs in excess of 60,000,000 ounces. Just how much production is likely to be stimulated by the bonus offered by the Government is not certain in view of the fact that silver is to a large extent a by-product of the production of other metals, the mining of which depends upon general industrial conditions.

Influence of Silver Purchases

So far as the supply of money is concerned, the purchase of 24,421,410 ounces of silver annually, half to be coined and half to be retained

in the Treasury, will involve the issue of only $15,500,000 of new silver dollars, a negligible sum in comparison with the total of over $5,800,000,000 of money in circulation. Moreover, even this increase in the supply of money is unlikely to affect correspondingly the volume of money in circulation, for experience has shown time and time again that money put out in excess of the requirements of trade promptly lodges in the banks and flows back to the Treasury and Federal Reserve Banks as fast as it is issued.

Of course, if the production of domestic silver is increased materially by the operation of the plan, and Government purchases are stepped up accordingly, the amount of new silver dollars issued will also be increased. Moreover, it must be remembered that the Government at any time may issue in the form of coinage the 50 per cent of silver tendered which it now proposes to retain in the Treasury. That such silver will sooner or later be coined and issued as money seems inevitable. With gold as the standard of value, it is always to be borne in mind that silver bullion is a Treasury asset only in the sense that pig iron or cord wood might be, except that there would be a possibility of selling the latter while the sale of silver is never to be thought of. The only way the Treasury can ever realize anything on its silver holdings is to coin them into money.

The extent to which the new plan may be expected to affect silver prices is also highly problematical. Prices to domestic producers will be raised, of course, by some 50 per cent. For the rest, however, prices will be benefited only to the extent that Treasury purchases will relieve the market of the American domestic production, which is a comparatively small proportion of total world production, the round figures for 1932 being 24,000,000 ounces for the United States against 165,000,000 ounces for the world total. It is true that the action of the United States in ratifying the London agreement represents an important step towards a general adoption of that plan, which would protect the world market from sales from the large overhanging government stocks. On the other hand, it must not be overlooked that there is nothing in the agreement to prevent sales of silver by private holders if prices should be deemed attractive by them.

Money and Banking

Aside from the announcement of the new Government program with regard to silver, the principal developments in the money situation during the month were a firming trend in interest rates, a seasonal expansion of currency in circulation in connection with the holiday trade, and an abatement of the Government's program of marking up the buying price for gold. On December 1 the gold price was raised 8 cents and on December 18 an additional 5 cents to $34.06 per ounce, these marking the only changes during the month. Actual purchases of gold since the promulgation of the gold buying order on October 22 were announced on December 21 to have been $62,000,000, of which $17,000,000 was bought in this country and $45,000,000 was bought abroad. At the same time it was announced that the Reconstruction Finance Corporation was seeking an additional allotment of funds to be devoted to this purpose.

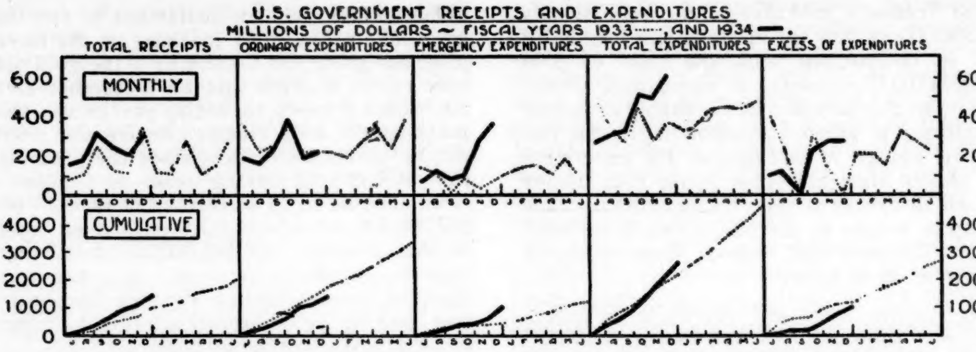
In the foreign exchange markets, the dollar moved somewhat higher during the month and is now selling on a gold basis more than 3 cents above the value fixed by the Treasury. Commodity prices, as measured by the general indexes, showed relatively little change during the month.

Call money, after having remained at ¾ of one per cent for more than four months, was raised to one per cent, and time loans, 4 to 6 months, were raised from ¾—1 to 1¼—1½. Bankers' acceptances were firmer, and the average discount rate on Treasury bill offerings moved up from 0.43 per cent on the issue dated November 29 to 0.73 per cent on that dated December 27.

The rate of 2¼ per cent carried on the offering of Treasury certificates on December 15, compared with only ¼ of one per cent on the previous issue of a smaller amount, dated September 15, reflects the substantial readjustment in Government security prices that took place during the intervening period. Inasmuch as the supply of money has continued large, it is apparent that the dominating influences in the Government market over recent months have been, first, the controversy over the money question, and, second, the prospect of large additional demands upon the capital markets in the future for financing the Government's requirements.

United States Government Finance

The scope of the Government's public works and relief program, and the expenditures involved, have made the subject of governmental finance one of the first importance. Although a report on receipts and expenditures is issued daily by the Treasury, comparatively few people receive the statement or have the figures necessary to give a continuous picture that will enable them to establish the trend from month to month. With a view, therefore, to aiding the reader in his understanding of the Treasury position and prospects for the budget, we present on the following page a chart showing both by months, and by cumulative totals since the beginning of



the fiscal year on July 1, 1933, how receipts, ordinary expenditures, emergency expenditures, total expenditures and the excess of expenditures or deficit, are running this year as compared with a year ago.

In further explanation of the chart, it should be said that the full line represents the current fiscal year ending June 30 next, while the dotted line is for the preceding fiscal year ended June 30, 1933. Payments into the sinking fund for debt retirement have not been included in the chart. Totals for December, 1933, have been estimated on the basis of actual figures through the 26th of the month.

It will be seen that receipts during the first half of the fiscal year have been running substantially in excess of receipts last year, because of larger yields from income taxes, customs and miscellaneous internal revenue, and returns from liquor taxes, emergency taxes provided in the National Industrial Recovery Act and the processing taxes on agricultural products, which were not in effect a year ago.

Ordinary expenditures, not including debt retirement, have been kept under last year for most months to date, and for the six months combined show a reduction of 16 per cent. As a consequence, however, of the recent rapid rise of emergency expenditures, the grand total of all expenditures is running substantially above 1932-33.

In considering emergency expenditures, it should be borne in mind that part of such outlays represents permanent improvements which will have value in the future; also that part covers loans and investments for which the Government expects to be reimbursed. Even so, however, such expenditures remain a part of the general problem of Treasury financing, regardless of the use to which the funds are put or their likelihood of being returned later on.

Notwithstanding this increase in expenditures the deficit on all accounts up to the end of October was less than a year ago. In November and December, however, the deficit was larger and at a rate which, if continued, will carry the cumulative total above that of last year. The situation, of course, during the balance of the year will be affected, on the one hand, by the expansion of the public works program, and any further relief appropriations that Congress may authorize, and, on the other, by the expected increase in yields from the liquor tax and such other revenue measures as may be adopted.

The Pan-American Conference

The Secretary of State, Mr. Hull, has gained a success at Montevideo similar to that which he gained in London. In each case, while the tangible results have not been large his efforts have been successful because they achieved the best that could be done under the difficult circumstances. His views upon international relations are well known. They have been stated with clarity and the force of conviction upon many occasions. He believes in the reciprocal advantages of natural trade. He has recognized that the world depression was primarily caused by derangements in trade relations, having their origin in the war, which have been aggravated by the efforts of nations to protect their home markets by means which have increased the disorganization, and has been anxious to cooperate in correcting these disorders. He was not able to accomplish concrete results at the London Conference, but he did not fail to impress that body with his purposes and his devotion to them.

It was not possible for the Conference at Montevideo to deal effectively with problems which the London Conference was not prepared to attack. The member countries of the Pan-American Union export a great proportion of their products to countries outside of the Americas, and their economic relations are with those countries, rather than between themselves, the chief exception being the important relations between all of them and the United States. They had been led to hope that the new administration at Washington might announce a change of policy that would

be helpful to them, but on the eve of the Conference an announcement at Washington indicated that the representatives of this country would be unable to make definite commitments on the uppermost subjects. This was discouraging, but Secretary Hull's statements, given out before sailing, on shipboard, and in addresses in Brazil, were such as to sustain interest and give hope of helpful counsels. There can be no question that the Secretary by his fair spirit, his evident desire to cooperate to the fullest extent possible, and the strength of his personality, made a very favorable impression upon the Conference. Moreover, it is safe to assume that he had the support of the President in utterances which go as far as general declarations can go. At last, the details of international relations must be determined in treaties and ratified by the parliamentary bodies. The resolutions advocated by him and adopted by the Conference are strong for a liberalization of trade relations and while urging a beginning by bilateral and multilateral treaties express the principle that equality of treatment shall be accorded to all.

United States Trade with Pan America

The interest of every country at this time centers upon the problem of finding a market for its products. On the whole, in the past, and even down to the present year, the United States quite regularly has bought more from the countries which are members of the Pan American Union than they have bought from it. The high point of Latin-American trade was recorded in 1920 when the aggregate of our exports to the group was $1,568,000,000 and aggregate of imports from it was $1,809,000,000. In 1929 with a much lower price level, corresponding figures were $972,900,000,000 and $1,106,900,000, but in 1932 they had fallen to $217,000,000 and $358,000,000.

Trade relations between countries are determined mainly by the natural exchangeability of products. This country in the past has freely received tropical products, as coffee, cocoa, bananas and sugar, until, in recent years, the production of sugar at home and in the insular possessions has reduced imports of that commodity, to the serious injury of Cuba. But the United States has had a frankly protective policy which has been unfavorable to imports which would compete with domestic products. There always is room for argument as to how far such a policy should dominate trade relations, but it has not been applied by this country with any unfriendly design and it is a common policy among nations.

In this trade the countries having the most important balances in their favor during 1932 were: Brazil $53,663,000, Colombia $50,175,000, Cuba $29,556,000, Venezuela $10,059,000, Chile $8,710,000. The trade with countries having adverse balances with the United States has fallen to a low volume. The most important of these was Argentina, and United States exports to Argentina and Uruguay and imports from these countries in the last five years are given herewith:

(In Millions of Dollars)

Year	Argentina Exports to	Argentina Imports from	Uruguay Exports to	Uruguay Imports from
1928	178.9	99.4	26.0	11.7
1929	210.3	117.6	28.2	18.7
1930	129.9	71.9	21.4	12.4
1931	52.6	36.0	9.5	3.9
1932	31.7	15.7	3.2	2.1

This state of trade has been the subject of comment and negotiation for some years, but so long as world trade as a whole was fairly well balanced and the gold standard was generally maintained, such differences in direct trade were not of large importance. Cash balances accumulated in trade or any business relations were readily transferred between the banks of all countries by cable or gold shipments, and so long as payments in the aggregate were approximately in balance these settlements could be made, because on the whole they offset each other.

The Necessity for Balanced Relations

We have had frequent occasions to emphasize that all business, directly or indirectly, consists of an exchange of services. It follows also that in the long run the exchanges must balance and settle themselves. The people of every section of this country pay for what they buy of the outside world by means of what they sell to it. If for any reason they are unable to sell in usual volume, they must reduce their purchases accordingly, except that they may temporarily cover the deficit by the use of credit in some form, or by reducing their reserves of ready money; but one way or another their accounts must be brought into balance if business relations are to continue. It is of course the same in trade between countries.

The gold standard as it existed before the war rendered highly useful services in international relations. Through it definite relations were maintained between the many monetary systems and thus a common basis was afforded for prices and all business intercourse. The confusion which has existed in all international prices since those fixed relations have been broken down shows how important this service was. The fact that gold could be shipped from one country to another in the settlement of balances was important in the adjustment of relations, but it is a mistake to think that great reserves of gold are necessary to the workings of a universal gold standard. The essential thing in the workings of the system is that the exchanges shall approximately bal-

ance without shipments of gold. Unless gold holdings are kept idle they cannot be transferred from one country to another in large sums without affecting economic conditions in both countries, and to keep large sums idle would be uneconomical and a charge upon all business. The talk about "broadening the monetary base" fails to take account that if the base were enlarged the superstructure of credit and prices would be enlarged correspondingly, unless the increased reserves were kept out of use by mandatory legal requirements, for use only when extraordinary transfers are required. Such reserve requirements would be burdensome instead of beneficial.

The benefits of trade and of a ready flow of capital between countries are all in an increased production and distribution of goods which minister to the general comfort and welfare. Under normal conditions all trade and international business tends to settle itself. The free play of economic forces tends to this result and the control which central banks have over the volume of bank credit (which in every country greatly exceeds the volume of money) enables them under ordinary conditions to hold the international balances within narrow limits. Nothing but the violent influences set in motion by war could cause such international shifts of trade, gold, securities and bank credit as have occurred since 1913.

It is important to recognize the abnormal and extraordinary character of these developments in considering everything that has happened in this period. At no previous time had the world economic system reached such a state of complexity and interdependence and no such general and violent disturbance ever had occurred. Business men and statesmen alike were without experience or historical records to guide them through such conditions. They were all opportunists, and even the most cautious and sagacious, if in the active management of affairs, were obliged to conform in large degree to circumstances which they could not control. Actual control did not exist anywhere.

The Exchange Situation in Argentina

Argentina is one of the countries which with the United States were benefited by the stimulus to agricultural production given by the war, and which are now suffering from the derangements that have resulted. It has been primarily an agricultural country, although in recent years numerous industries have developed for supplying home wants. The railroads and public utilities have been constructed mainly by foreign capital, and much of the capital used in general business has been supplied in like manner. It has been necessary that the country's exports should cover the value of all importations of merchandise, together with the other expenditures of the Argentine people abroad, plus annual returns on foreign investments in the country. In ordinary times this was done with ample margin. In the years of prosperity since 1914 the obligations abroad were considerably increased and the exports of the country were increased both in physical volume and money value, but when the prices of Argentine products declined to 50 per cent and less of the prices of pre-war years the balance of payments became adverse. For a time the authorities followed the usual policy of meeting the adverse exchanges by shipping gold from the ample reserves, but when it became apparent that the situation might be protracted, gold payments on private account were suspended, but have been continued to the present time to meet all foreign obligations of the national government.

The inability of exchange dealers and other private parties in Argentina to obtain gold for shipment made it impossible to obtain means of foreign payments in sufficient amount to satisfy all demands. Debtors might have domestic currency in sufficient amounts, but since this could not be used abroad or converted into foreign money, the competition for a limited amount of foreign exchange caused the latter to go to a premium, or in other words, the domestic currency became depreciated. This had the effect of increasing the cost of foreign goods and served automatically to reduce the volume of imports. Nevertheless, they continued on a reduced scale, and a large body of what have been called "blocked funds" accumulated in the banks, paid in for the account of foreign creditors and awaiting means of conversion into foreign currencies. The total of such funds was estimated at one time last year at 300,000,000 Argentine pesos (value of the peso in United States money at par for both .4245 cents). The bulk of these funds was awaiting conversion into either British sterling or United States dollars.

Conversion Into Long-Term Bonds

Last May a treaty was negotiated between the Governments of Great Britain and Argentina which contained an arrangement by which holders of these pesos might convert them into 20-year 4 per cent bonds of the Argentine Republic, payable in London in pounds sterling over a period of twenty years with cumulative semi-annual amortization payments at 5 per cent commencing after the fifth year. This arrangement with Great Britain has led to a similar arrangement between the Argentine Government and American holders of "blocked funds," which went into effect De-

cember 1, 1933. Under it American owned pesos may be converted into a series of notes of the Argentine Republic, payable in United States dollars and maturing monthly over fifteen years, with amortization payments at varying rates and bearing interest at 2 per cent. Furthermore, after one-fifth of any series of these notes shall have been redeemed the remainder may be converted into twenty year 4 per cent dollar bonds, which are described as being similar in terms to the bonds issued under the treaty with Great Britain as above.

The Present Situation

The clearing up of the accumulated "blocked funds" by the Government note and bond issues described above has improved the Argentine exchange situation for the present, but the cause of all the trouble, unbalanced trade, remains. At a dinner given by the Chamber of Commerce of the United States in Buenos Aires on October 14th last to the Hon. Alexander W. Weddell, lately arrived Ambassador of the United States to Argentina, the Hon. H. E. Ing. Luis Duhau, Argentine Minister of Agriculture, made a frank exposition of the situation. He said, in part:

> Our exports are falling off violently, on which depend, almost exclusively, the economic life of the country. The consequences are extremely serious. We find ourselves forced to restrict purchases abroad and to fetter the remittances on foreign capital through the control of exchange. Argentine imports today amount to about 900,000,000 paper pesos, and this year we shall not have more than 1,000,000,000 paper pesos of exchange available. There would remain, therefore, only 100,000,000 for services on the public debt, private capital, and other remittances which last year required over 500,000,000 pesos. Hence, we do not have any other remedy than to continue curtailing and to slash in a drastic form. And if trends do not favor us in 1934, we shall have to do it implacably. Unfortunately, the diminution in our capacity to pay does not permit us to continue buying, as we have done up to the present, from the United States. In 1932 we purchased from the United States up to the value of 113,000,000 paper pesos; moreover we paid the United States 80,000,000 paper pesos service on the public debt of Argentina, without taking into consideration the requirements for the municipal and provincial debts and for the capital of private companies. But the United States hardly bought from us 44,000,000 pesos, or let us say about one fifth of that which we were called upon to remit to that country.
>
> This situation has become then indefensible and we do not have even in the least bit the consolation of that famous sophism of a triangular compensation, in a world shackled by a thousand and one commercial restrictions.

This situation obviously increases the importance of a direct trade which liquidates itself. The largest importer of Argentine products is Great Britain and the treaty referred to above contains a provision that the credits established in Great Britain by such imports shall be first available for the liquidation of Argentine purchases or fixed obligations in Great Britain. It is well known that under the Ottawa Agreement the British overseas dominions are pressing the mother country to reserve a larger share of its imports of agricultural products to them, and that British purchases in Argentina have been curtailed to some extent on that account. The Argentine minister in this speech frankly said that the purchases of his country abroad "must be directed to protect certain zones of relatively unhampered trade."

A World Situation

It is evident that the difficulties which affect Argentina are common over the world. The "blocked marks" of Germany are a familiar story. They consist of sums in German currency which have been paid by German debtors for transfer to foreign creditors, but which can be transferred only in part. The League of Nations loans made to several nations some years ago are in similar default, as are many other loans public and private. Every such case affords tangible proof of the affirmation that great payments can be made from one country to another only in the form of goods and services, and that attempts to make them by transfers of gold from banking reserves are a menace to the stability of monetary systems. Under any monetary system the main affirmation would remain true.

Without a common standard of value to which the principal monetary systems are related, international business relations fall into chaos. Instead of the business men of every country being able individually to sell their products in all markets as they can find buyers, without regard for other selling and buying to which they are not related, the tendency is to restrict trade to direct arrangements between countries and under the control of governments. The effect of these conditions is seen in the declining trade of the United States with the Latin-American countries since 1929, and in the decline of the total of international trade, which according to the economic bureau of the League of Nations declined 60 per cent from 1929 to 1932. If it be said that the decline is not wholly due to the disruption of exchange relations, the answer is that fundamentally the trouble has been in the physical exchanges themselves. The monetary exchanges reflect the exchanges of goods and services and the prices at which they are valued to each other. When the physical exchanges and the price relations fall into disorder the monetary exchanges are disrupted, and this in turn increases the confusion in the price relations and physical trade.

Furthermore, all of this is as true throughout domestic trade as in international trade. The commodities and services moving in trade constitute the only purchasing power in the markets and unless all varieties of them are in right relations to each other, in volume and price, trade will languish in a state of blockade.

Quicker Collections

The goal of every bank and business house

OUR new methods provide extremely efficient collection and remittance of domestic commodity and security drafts. Funds are made quickly available at the most convenient concentration centers.

Advices of payment or nonpayment by wire or air mail result in simple, fast and accurate accounting and reconcilement. The centralization of tracings makes for speed and economy.

These methods are a definite forward step in modern banking practice. Many banks and business houses could use them with profit. Our representatives can tell you whether they would result in savings over your present system.

THE NATIONAL CITY BANK OF NEW YORK

Established 1812

Printed in U.S.A.

ed in U.S.A